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IN THE

Supreme Court of the United States.

OCTOBER TERM, 1931.

No. 560.

CONTINENTAL TIE AND LUMBER COMPANY,
PETITIONER,

v.

THE UNITED STATES.

Brief of Petitioner On Writ of Certiorari to the Court of Claims.

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CONTINENTAL TIE AND LUMBER COMPANY, *Petitioner*,
v.
THE UNITED STATES.

BRIEF OF PETITIONER ON WRIT OF CERTIORARI TO THE COURT OF CLAIMS.

I. THE OPINION OF THE COURT BELOW.

The opinion of the Court of Claims (R. 15) is reported in 52 Fed. (2d) 1045.

II. JURISDICTION.

The jurisdiction of this Court is invoked under Section 240 of the Judicial Code as amended by the Act of February 13th, 1925 (U. S. C., Title 28, Sec. 288), and under Section 1003 of the Revenue Act of 1926 (U. S. C., Title 26, Sec. 1226).

A petition for certiorari was filed December 8, 1931 (R. 22), and was granted February 15, 1932 (R. 23).

III. STATEMENT OF THE CASE.

The Continental Tie and Lumber Company, petitioner, is a corporation engaged in the lumber manufacturing business and with principal office at Denver, Colorado. In 1907 petitioner incorporated a logging railroad known as "The Cimarron and Northwestern Railway Company" and ever since that time has owned the entire capital stock of said railroad company. (R. 12.)

Throughout the period December 28, 1917, to June 3d, 1918, inclusive, the Cimarron and Northwestern Railway Company was in possession and control of and operated by the President of the United States, through the Director-General of Railroads. On the latter date the road was relinquished from Federal control by the Director-General. (R. 12.)

On October 19th, 1923, the Cimarron and Northwestern Railway Company received from the Treasurer of the United States the sum of $25,228.35 which was paid to it pursuant to the provisions of Section 204 of the Transportation Act of 1920. (R. 13.)

Petitioner rendered a consolidated income tax return for itself and its subsidiary, the Cimarron and Northwestern Railway Company, for the year 1920. In auditing said return the Commissioner of Internal Revenue included therein as income the aforesaid payment of $25,228.35. (R. 12–13.)

In due time petitioner filed a claim for refund with the Commissioner of Internal Revenue wherein it was contended that said payment under Section 204 of the Transportation Act of 1920 did not constitute taxable income to the Cimarron and Northwestern Railway Company and should not be included in the consolidated net income for 1920. The Commissioner of Internal Revenue denied the claim and suit was instituted in the Court of Claims thereon. The Court of Claims agreed with the Commissioner of Internal Revenue and in decision entered October 20th, 1931, held that said amount constituted taxable net income to the Cimarron and Northwestern Railway Company in the year 1920 and should be included in the consolidated net income for said year. (R. 15 and refund claim, R. 6–8.)

IV. THE LAW INVOLVED.

The statutory provisions involved are set out in the appendix hereto, consisting of excerpts from the Revenue Act of 1918 and the Transportation Act of 1920.

V. SPECIFICATIONS OF ERROR.

1. The Court of Claims erred in finding and holding that the payment in 1923 of $25,228.35 to the Cimarron and Northwestern Railway Company, under the provisions of Section 204 of the Transportation Act of 1920, constituted taxable income to said Company.

2. The Court of Claims erred in finding and holding that the payment of $25,228.35 to the Cimarron and Northwestern Railway Company in 1923 under the provisions of Section 204 of the Transportation Act of 1920, even though taxable, constituted income in 1920.

3. The Court of Claims erred in entering judgment for petitioner only in the amount of $200.00, when it should have given judgment also for $2,522.84, representing the tax paid on the item of $25,228.35 here in controversy.

VI. ARGUMENT.

The question here is as to the taxability in 1920 of a payment made to the Cimarron and Northwestern Railway Company in 1923 of $25,228.35, under the provisions of Section 204 of the Transportation Act of 1920.

The Cimarron and Northwestern Railway Company was affiliated with petitioner throughout 1920 within the purview of Section 240 of the Revenue Act of 1918, and the two companies rendered a consolidated income tax return for that year. The two companies kept books and rendered returns on the accrual basis. (See Finding 5 of the Court, R. 15.)

Section 213 (a) of the Revenue Act of 1918 (set out in full in the appendix), provides that all gains and profits of a taxpayer shall be included in gross income. Invoking the authority of this section the Commissioner of Internal Revenue included in 1920 income the item of $25,228.35 here in dispute.

Section 213 (b) (3) of the Revenue Act of 1918 (see appendix) provides that the value of property acquired by gift shall be excluded from gross income. Under the provisions of this section petitioner contends that the item of $25,228.35 should be excluded from gross income.

The argument then resolves itself into two questions:

First. Did the payment to the Cimarron and Northwestern Railway Company under the provisions of Section 204 of the Transportation Act of 1920 constitute gains or profits to it?

Second. If it did, was that gain or profit taxable in 1920 or in 1923 when it was determined and paid?

These questions form the basis of the following argument:

A.

Payments under Section 204 of the Transportation Act of 1920 do not constitute taxable income.

The question of what constitutes taxable income has been before this Honorable Court a number of times. In *Eisner* v. *Macomber*, 40 S. Ct. 189; 252 U. S. 189, a case arising under the Revenue Act of 1916, this Court said:

> "(6) After examining dictionaries in common use (Bouv. L. D.; Standard Dict.; Webster's Internat. Dict.; Century Dict.), we find little to add to the succinct definition adopted in two cases arising under the Corporation Tax Act of 1909 (Stratton's Independence *v.* Howbert, 231 U. S. 399, 415, 34 Sup. Ct. 136, 140 [58 L. Ed. 285]; Doyle *v.* Mitchell Bros. Co., 247 U. S. 179, 185, 38 Sup. Ct. 467, 469 [62 L. Ed. 1054]), 'Income may be defined as the gain derived from capital, from labor, or from both combined,' provided it be understood to include profit gained through a sale or conversion of capital assets, to which it was applied in the Doyle Case, 247 U. S. 183, 185, 38 Sup. Ct. 467, 469 (62 L. Ed. 1054).
>
> * * * * * * * * * *
>
> "The government, although basing its argument upon the definition as quoted, placed chief emphasis upon the word 'gain,' which was extended to include a variety of meanings; while the significance of the next three words was either overlooked or misconceived. *'Derived—from—capital'; 'the gain—derived—from—capital,' etc.*"

Nothing has been added to or taken from this definition of income since it was promulgated in 1919.

Obviously the payment under Section 204 was not derived from capital or labor of the Cimarron and Northwestern

Railway Company and was not derived from the sale of any of its capital assets. *It therefore does not fall within the definition of income as stated by this Honorable Court.*

The payment under Section 204 was not a payment of any obligation due to the Cimarron and Northwestern Railway Company from the United States. The payment of $2,000.00 on June 28th, 1923, by the Director-General of Railroads *was settlement in full of all claims arising out of federal control and constituted the final settlement between the Director-General and the Cimarron and Northwestern Railway Company.* (See first paragraph of Finding 4 of the Court of Claims, R. 12.) On October 13, 1923, after said final settlement was made, the Interstate Commerce Commission determined that $25,228.35 was due the Cimarron and Northwestern Railway Company under Section 204 of the Transportation Act and thereupon certified that amount to the Secretary of the Treasury for payment. *Thus the payment in question was not the fulfillment of any obligation on the part of the Government.* It was nothing more than a bounty or subsidy which Congress saw fit to give and, therefore, *a gift* to be excluded from income under Section 213 (b) (3) of the Revenue Act of 1918. (See appendix.)

The Transportation Act of 1920 provided for the turning back of the railroads to the carriers and for settlement of all differences and compensation due. It is interesting to note that the payment therein provided to be made to the trunk line railroads which were turned back at that time under Section 209 of the Act is referred to as a guaranty, while in Section 204 of the Act, which deals with short line railroads not then under Federal Control, *Congress studiously avoided using the term guaranty or any term implying compensation.*

It is patent that "income" as defined by this Honorable Court arises only through contract, express or implied. In Finance Docket No. 1176 the Interstate Commerce Commission, having under consideration the provisions of Section 209 of the Transportation Act of 1920, said:

> "The guaranty under section 209 is wholly independent of any damages which the carriers may have suffered by reason of the temporary taking of their property during

> the period of federal control. For all such damages the government must render just compensation; and by their acceptance of the provisions of section 209 the carriers have in no way surrendered or abated any claims arising out of federal operation. The guaranty, therefore, *was not founded upon a legal obligation*, but upon the thought that in fairness it was the duty of the government to protect the income of the carriers, following the termination of federal control, until such time as higher rates could be made effective under the provisions of section 15a of the interstate commerce act." (Italics supplied.)

The Interstate Commerce Commission is the governmental agency which has construed and applied the Transportation Act of 1920. All of its dealings and settlements with the railroads and all accounting matters since July 12, 1921, the date of that decision, have been made in the light of the above quoted interpretation and holding. *Then, if the guaranty payments made to the trunk line railroads under section 209 were "not founded upon a legal obligation" of the Government, and therefore not income, how much more true would this be of the payments made under Section 204 to short line railroads which had previously been relinquished from Federal control and with whom settlements in full had been made.*

In *Edwards* v. *Cuba Railroad Company*, 45 Sup. Ct. 614, 268 U. S. 628, this Honorable Court held that subsidies paid to the railroad by the Cuban Government did not constitute taxable income within the meaning of the 16th Amendment to the Constitution, even though the railroad had to comply with certain definite requirements in order to receive the subsidies, among which was the building of additional lines into new territory. In its opinion the Court, among other things, said:

> "The subsidy payments taxed were not made for services rendered or to be rendered. They were not profits or gains from the use or operation of the railroad, and do not constitute income within the meaning of the Sixteenth Amendment. See Stratton's Independence *v.* Howbert, 231 U. S. 399, 415, 34 S. Ct. 136, 58 L. Ed. 285; Eisner *v.* Macomber, 252 U. S. 189, 207, 40 S. Ct. 189,

64 L. Ed. 521, 9 A. L. R. 1570; Merchants' Loan & Trust Co. *v.* Smietanka, supra."

In the Cuba Railroad case the railroad was required to do certain things and construct certain lines in addition to operating its railroad. In the instant case the railroad was not required to do anything [redacted] If the subsidies paid by the Cuban Government were not for services and were not profit or gain from the use or operation of the railroad, how much more true is it that the payments made to short line railroads by the United States under Section 204 of the Transportation Act of 1920 did not constitute "income."

Section 204 placed no obligation on the railroads. The obligation was on the Interstate Commerce Commission to ascertain and certify to the Secretary of the Treasury the amounts to be paid and on the Secretary of the Treasury to pay such amounts as were certified. If these payments had been obligations, the Government would doubtless have hastened settlement and payment. On March 4, 1927, Congress amended Section 204 by adding thereto a new paragraph reading as follows:

> "(h) This section shall not be applicable to any carrier which has not, on or before the expiration of sixty days after this subdivision takes effect, filed with the commission a statement, compiled substantially in the manner prescribed in this section, showing the amount claimed to be due such carrier under this section." (U. S. C. Title 49, Sec. 73 (h).)

Thus the only requirement imposed on the short line railroads was imposed in 1927, after petitioner and most of the other railroads had been paid. This amendment discloses an intent on the part of Congress not to fulfill an obligation of the Government but to fix a time when its generosity should cease.

Wherefore, it is submitted that the payment of $25,228.35

to the Cimarron and Northwestern Railway Company in 1923, under the provisions of Section 204 of the Transportation Act of 1920, did not constitute taxable income to it.

B.

Even if it should be held that the payment to the Cimarron and Northwestern Railway Company in 1923 constituted taxable income under Section 204 of the Transportation Act of 1920, it was not income within the year 1920.

Petitioner and the Cimarron and Northwestern Railway Company kept books and rendered income tax returns on the accrual basis. The question then is:

> Was the payment of $25,228.35 to the Cimarron and Northwestern Railway Company in 1923 under the provisions of Section 204 of the Transportation Act, 1920 (if income at all), *accruable* on its books and in its tax return in the year 1920?

The grounds on which it is contended that this question should be answered in the negative are discussed under the following heads:

1. The Cimarron and Northwestern Railway Company had no enforceable claim against the United States in 1920.
2. The events which fixed the amount payable had not all occurred in 1920.
3. No determination of any amount payable was made by the Interstate Commerce Commission until in 1923.

1. *The Cimarron and Northwestern Railway Company had no enforceable claim against the United States in 1920.*

The payments under Section 204 of the Transportation Act, 1920 (41 Stat. 460), were to reimburse common carrier railroads for deficits incurred by them during that portion of the Federal control period during which they were not under Federal control. (See Section 204, appendix.) At the time of such enactment the said railroads had no enforceable claims for deficits arising in that period. Did the section give rise to any such enforceable claims?

Section 204 provides that the Interstate Commerce Commission "shall ascertain for every carrier" the amounts of such deficits and that it "shall promptly certify to the Secretary of the Treasury the several amounts payable" and that "The Secretary of the Treasury is hereby authorized and directed *thereupon* to draw warrants in favor of each such carrier * * * for the amount shown in such certificate as payable thereto." (Italics added.)

The act makes no provision for appeal from the determination of the Commission and the carrier therefore had no option but to take what the Commission certified and what the Secretary of the Treasury paid. Mandamus would not lie to compel an allowance. *United States ex rel. Abilene & L. Railway Company* v. *Interstate Commerce Commission*, 8 F. (2d) 901, certiorari denied, 270 U. S. 650; *cf. Interstate Commerce Commission* v. *United States*, 17 F. (2d) 860. Nor could the action of the Commission be reviewed by a District Court under the Urgent Deficiencies Act of October 22, 1913, 38 Stat. 208, 220. See *Great Northern Railway Company* v. *United States*, 277 U. S. 172. Nor could the determination by the Commission be reviewed by certiorari. See *Northern Pacific Railroad Company* v. *Interstate Commerce Commission*, 23 F. (2d) 221, certiorari denied, 275 U. S. 572. Nor could suit be brought against the United States for an amount claimed. See *Williamsport Wire Rope Company* v. *United States*, 277 U. S. 551, wherein this Court said:

> "But we have held that the Court of Claims is without jurisdiction where the statute creating the claim expressly refers it for final determination to an executive department. U. S. *v.* Babcock, 250 U. S. 328, 331. And that it is equally without jurisdiction where from an examination of all the terms of the statute it appears that Congress intended to vest final authority in an administrative agency. United States *v.* Atchison, Topeka & Santa Fe Ry. Co., 249 U. S. 451; Silberschein *v.* United States, 266 U. S. 221. Long ago Congress conferred final authority upon such an agency in the enforcement of the appraisal provisions by which the amounts payable under the customs laws are determined. Compare Bartlett *v.* Kane, 16 How. 263, 272; Hilton *v.* Merritt, 110 U. S. 97, 105; Passavant *v.* United States, 148 U. S. 214."

Being thus at the mercy of the Interstate Commerce Commission, the Cimarron and Northwestern Railway Company had no enforceable claim against the United States in 1920 and at no time prior to final determination by the Interstate Commerce Commission in 1923. There could therefore be no accrual in 1920.

2. *The events which fixed the amount payable had not all occurred in 1920.*

The reasoning upon which the Court of Claims reached the conclusion that the payment under Section 204 of the Transportation Act, 1920 (41 Stat. 460) was income for the year 1920 proceeds upon the assumption that the amount to be paid could be computed or reasonably estimated for the purpose of accrual in 1920 from facts then in the possession of the railway company. The carrier's rights, such as they were, were fixed by Section 204, which provides in subdivision (c) that as soon as practicable after March 1, 1920, the Interstate Commerce Commission shall, in effect, ascertain the extent to which the railway operating income of each carrier during the so-called Federal control period fell short of its railway operating income for the corresponding so-called test period. Section 204 (b) provides:

> "(b) For the purposes of this section—
>
> "Railway operating income or any deficit therein for the period of Federal control shall be computed in a manner similar to that provided in section 209 with respect to such income or deficit for the guaranty period."

The Interstate Commerce Commission reports apparently contain no separate general instructions to carriers having claims under Section 204 as to the data to be reported by them to enable the Commission to compute their railway operating income for the control period. Since, however, railway operating income for the Federal control period for the purposes of Section 204 is directed to be computed in a manner similar to that provided in Section 209 (41 Stat. 464) with respect to the so-called guaranty period, it seems clear that amounts payable

to carriers under Section 204 could not be accrued unless amounts payable under Section 209 could also be accrued. An examination of Section 209 and the successive orders issued by the Commission affecting the determination of railway operating income under that section shows, it is submitted, that railway operating income for that period and therefore for the control period under Section 204 could not have been ascertained for the purpose of accruing within the year 1920 amounts payable to carriers under those sections.

Section 209 (f) prescribes the method of computation to be followed. Subdivision (3) provides, "There shall not be included in operating expenses, for maintenance of way and structures, or for maintenance of equipment, more than an amount fixed by the Commission." While it might be supposed from the following sentence, providing for the application so far as practicable of the "rule set forth in the proviso in paragraph (a) of section 5 of the 'standard contract' between the United States and the carriers," that the amount which the Commission would fix under subdivision (3) for maintenance expenses could be rather definitely anticipated, this was not the case, as is shown by the successive orders of the Interstate Commerce Commission, referred to below, issued from time to time after 1920. Again, in Section 209 (f) (5), the Commission is directed to require the elimination and restatement of the operating expenses and revenues (other than for maintenance) for the guaranty period, "to the extent necessary to correct and exclude any disproportionate or unreasonable charge to such expenses or revenues for such period."

The successive instructions issued by the Commission show the impossibility of determining in 1920 how much the Commission would allow either under Section 209 or Section 204. The first set of instructions of the Commission with respect to accounting procedure to be observed by carriers for the purpose of determining railway operating income under Section 209 was issued on June 10, 1920, and is printed at 70 I. C. C. 717. In paragraph 9 the order of the Commission states that "Reserve accounts created to reflect accruals pertaining to guaranty-period transactions will be closed out or adjusted on the basis of actual expenditures within such a reasonable time after

August 31, 1920, as the Commission may determine." This "reasonable time" within which regular accrual-basis entries were to be adjusted to a cash basis was not fixed by the Commission until December 15, 1921, on which date it fixed the termination of the "reasonable time" at December 31, 1921. Finance Docket No. 1606, *Final Settlement under Section 209*, 70 I. C. C. 711, 712. In the meantime, as the report shows at p. 714, it had, by orders of October 18, 1920, and January 5, 1921, required carriers to furnish certain information to enable the Commission properly to discharge its duties under Section 209. From information so obtained and after extensive argument on the part of the carriers, the Commission on July 12, 1921, in Finance Docket No. 1176, *Maintenance Expenses under Section 209*, 70 I. C. C. 115–129, "indicated the general principles for fixing the maximum charges to operating expenses for maintenance under the act." In Finance Docket No. 1606, *supra*, 70 I. C. C. 711, 714, the Commission stated the outcome of its study:

> "Upon consideration of the returns to our orders of October 18, 1920, and January 5, 1921, and as a result of investigations made for the purposes of the definite determinations required for partial payments under section 212 of the act, in addition to the facts considered in Finance Docket No. 1176, *Maintenance Expenses under Section 209*, *supra*, we are of the opinion that the allowances for differences that may exist between the cost of labor and material for the test period and for the guaranty period, respectively, *can not practicably be made upon the basis of any rigid rule or formula, but these allowances must be fixed by us in the exercise of a reasonable judgment upon consideration of all the relevant facts and circumstances.*". (Italics added.)

The complications confronting the Commission fully appear from the pages of its report. The elaborate determination of applicable principles, made by the Commission, at the cost of so much pains and labor as well as disagreement on the part of its members and with the assistance of the entire transportation industry, long after 1920 could not, it is submitted, have been anticipated by any carrier and made the basis of even an estimate for accrual purposes.

The result of this study of maintenance expenses was a general formula for fixing the maximum amounts to be charged to operating expenses for maintenance which is stated at 70 I. C. C. 715–716, in an order promulgated December 15, 1921. In its promulgation the Commission plainly showed that the formula could not be applied by the carriers without further exercise of judgment by the Commission itself, since in the same order (70 I. C. C. 711, 714) the Commission directed carriers to submit *estimates* of the net effect of deferred debits and credits which could not as of December 31, 1921, be definitely determined, for action of the Commission under paragraph (b) of Section 212 of the Transportation Act, 1920. This section was added to the Transportation Act by amendment on February 26, *1921* (41 Stat. 1145) providing for certification by the Commission to the Secretary of the Treasury of partial amounts payable under Section 204 or Section 209. Further mention is made of this provision hereafter.

The Commission in its report of December 15, 1921, 70 I. C. C. 711, 715–716, said, "We will proceed to final settlement of each case upon the filing of the accounting returns now called for by Exhibits A, B, C, and D, and the adjustment return called for by Exhibit E, in the list of forms hereto annexed." These five exhibits cover 28 pages of the report, and the variety of detailed information called for by them can only be appreciated upon direct examination. Most of the information called for evidently had not been required under previous orders of the Commission. It is especially to be noted that by Exhibit D, Schedule 2 (70 I. C. C. 724), and by Exhibit D, Schedule 7 (70 I. C. C. 727), the order of the Commission called for a report of facts which had not happened at the end of 1920. This was quite in accordance with the instruction of Congress in Section 209 (f) (3) and (5).

Further announcement of the Commission's interpretation of Section 209 and its procedure thereunder was made in Finance Docket No. 2797, *Treatment of Salvage, Piece Work and Prices under Section 209*, 82 I. C. C. 678, dealing with factors to be applied to charges to operating expenses for maintenance. It is submitted that the elaborate system of territorial factors and individual differentiation developed by

the Commission between 1920 and 1923, as shown by this report (dated August 15, 1923), could not have been anticipated by any carrier, short line or transcontinental, in 1920.

The published view of the Commission is that the amounts payable under Section 209, and therefore under Section 204, could not be determined in 1920. In Finance Docket No. 501, *Guaranty Settlement with Great Northern Railway Company and Affiliated Companies*, 111 I. C. C. 318, 319-320, the Commission said:

> "It is obvious that the amounts necessary to make good the guaranty to the several carriers could not be determined until after the close of the guaranty period and the closing of the books of accounts of the carriers with respect to the charges attributable to that period, *and until we had determined the principles which should govern in final settlement.* * * *
>
> "When these certificates for partial payments were issued, there were certain questions with respect to the interpretation of section 209 which we had not finally determined, nor were the books of accounts of the carriers closed with respect to the charges attributable to the guaranty period. Hence final ascertainments of the amounts due under the guaranty could not be made. * * *" (Italics added.)

The extent to which the Commission adjusted the railway operating income, as it would ordinarily be calculated from books kept in accordance with its prescribed classifications of accounts, is illustrated by Finance Docket No. 377, *Guaranty Settlement with Chicago, Indianapolis & Louisville Railway*, 111 I. C. C. 355, 357, in which the Commission partially disallowed fire losses suffered during the guaranty period. This ruling was made on the analogy afforded by Section 209, which provides for disallowance of maintenance expenses in excess of an amount fixed by the Commission, based on maintenance expenses during the test period. Irrespective of its merits, the decision could hardly have been anticipated in 1920. It appears also that it was necessary in the cases of some items either to apply a flat formula or make arbitrary separations in book charges. 111 I. C. C. 318, 331. With so

many issues of fact and law depending upon quasi-judicial determination by the Commission, it is submitted that claims under Sections 204 and 209 have the status of litigated claims the amount of which could not be accrued until final judgment.

Even if the formula for determining railway operating income had been sufficiently certain in 1920 to make possible a reasonable estimate of the amount to be paid under Section 204, it is submitted that action by the Commission upon the particular carrier's claim would be a condition precedent to its accrual. Section 204 (c) directs that "As soon as practicable after March 1, 1920, the Commission shall ascertain" the railway operating income factors going into the determination of the amount due. Section 204 (g) provides, "The Commission shall promptly certify to the Secretary of the Treasury the several amounts payable to carriers under paragraph (f). The Secretary of the Treasury is hereby authorized and directed *thereupon* to draw warrants in favor of each such carrier upon the Treasury of the United States for the amount shown in such certificate as payable thereto." (Italics added.) The amount therefore was not due, and could not be paid, until certified by the Commission. While in Section 209 (h) provision was made for advances on account of payments necessary to make good the *guaranty* provided for in that section, there was no provision for advances to carriers with claims under Section 204. The Secretary of the Treasury having refused to honor certificates for advances under Section 209 made by the Commission in favor of carriers who had not applied therefor during the guaranty period (see *Northern Pacific Railway Company* v. *Interstate Commerce Commission*, 23 F. (2d) 221, certiorari denied 275 U. S. 572), Congress, on February 26, 1921, added Section 212 to the Transportation Act (41 Stat. 1145). This provision for the first time enabled carriers claiming under Section 204 to obtain certificates for partial payment. Section 212 (a) provides in part:

> "In making certifications under section 204 or section 209, *the Commission, if not at the time able finally to determine the whole amount due* under such section to a carrier * * * may make its certificate for any amount definitely ascertained by it to be due * * *." (Italics added.)

Recognizing that the inability of the Commission at such time finally to determine the whole amount due did not arise out of failure to ascertain existing facts, Congress provided in Section 212 (b):

> "In ascertaining the several amounts payable under either of such sections, the Commission is authorized, in the case of deferred debits and credits which can not at the time be definitely determined, to make, whenever in its judgment practicable, a reasonable estimate of the net effect of any such items, and, *when agreed to by the carrier* or express company, to use such estimate as a definitely ascertained amount in certifying amounts payable under either of such sections and such estimates so agreed to shall be prima facie but not conclusive evidence of their correctness of amount in final settlement." (Italics added.)

If Congress had to recognize in 1921 that definite ascertainment of amounts due under Section 204 was still impossible, it is submitted that it was likewise impossible to the carriers in 1920. Nor can it be said that an estimate would do, since Congress in 1921 for the first time authorized the Commission to certify amounts due under Section 204 upon "a reasonable estimate" of the net effect of deferred debits and credits which could not at the time of the certification be definitely determined, and moreover that only when agreed to by the carrier. Even estimates so agreed to became only prima facie evidence of the correctness of their amount in final settlement.

Even as late as 1922, there was still a question as to what carriers came within the provisions of Section 204. 99 I. C. C. 724, overruling 66 I. C. C. 765.

Certifications of amounts due under Section 204 were expressly made conditional upon acceptance by the carrier of the amount so certified in final settlement of all its claims against the United States under that section. That the Cimarron and Northwestern Railway Company, like other carriers, so agreed (see *e. g.*, 71 I. C. C. 492, 823, 825, 853, 863) appears from the certificate of the Commission set out in paragraph 4 of the special findings of fact. Since the carrier could not resort to the courts for redress, it is evident that,

once the Commission had made up its mind as to the amount it would allow, the carrier, whether it agreed or not, had little choice but to accept. At any rate it could not obtain action from the Commission without accepting. It is submitted that a future right to the payment of an indefinite and undeterminable amount to be arrived at by agreement with the Interstate Commerce Commission can not be accrued until the agreement is reached.

3. *No determination of any amount payable was made by the Interstate Commerce Commission until 1923.*

On November 3, 1922, the Cimarron and Northwestern Railway Company furnished the information and data requested by the Commission in its form "Report of Deficit Roads under Section 204 of the Transportation Act of 1920." Thereafter a Commission accountant examined the Railway Company's accounts and determined a net credit in its favor under Section 204 of $42,594.76. The Bureau of Finance of the Interstate Commerce Commission then considered the matter and by letter dated April 12, 1923, notified the carrier that nothing was due, but gave leave "to submit additional data as to relative costs between the test period and the period of Federal control during which it operated its own road, this evidence to be considered in deriving a factor which might be applied to the carrier's claim and furnish a basis for its allowance." The result constituted "its exercise of a reasonable judgment upon consideration of all the relevant facts and circumstances," to make allowance, by the application of a factor, for differences between costs of labor and material for the test period and for the period of Federal control which "can not practicably be made upon the basis of any rigid rule or formula." See 70 I. C. C. 711, 714, *supra*. The additional data were furnished and on October 13, 1923, the Commission certified to the Secretary of the Treasury that the sum of $25,228.35 was payable under Section 204 (Finding 4, R. 13).

In its final decision the Interstate Commerce Commission, among other things, said:

"The carrier was under Federal control from January 1, 1918, to June 3, 1918, inclusive, and is entitled to the benefits of section 204 for the period from June 4, 1918, to February 29, 1920, inclusive. Its return under our circular of March 4, 1920, indicated a net credit of $45,090.57 in its favor for the period from January 1, 1918, to February 29, 1920, inclusive. Our examination of its accounts for the period from June 4, 1918, to February 29, 1920, inclusive, shows the net credit to the carrier for that period to be $42,594.76 before making the adjustments under the provisions of paragraph (f) of section 209, required by paragraph (b) of section 204.

"Consideration has been given by us to the adjustment of maintenance charges and applying, so far as practicable, the rule set forth in the proviso of paragraph (a) of section 5 of the standard contract between the director general and carriers under Federal control, we have disallowed $17,366.41 of the maintenance expenditures for the period in question." (Finding 4, R. 14.)

Thus it appears conclusively from the record that no determination of any amount payable was either tentatively or finally made until in 1923 and, furthermore, as shown in the second proposition above, that no such determination was possible until the Interstate Commerce Commission made "the adjustments under the provisions of paragraph (f) of section 209, required by paragraph (b) of section 204," in accordance with the general formula first announced in December, 1921. 70 I. C. C. 711, 714–715.

If the Cimarron and Northwestern Railway Company had been compelled to accrue for income tax purposes in 1920 an amount due it under Section 204, it would have had to accrue the amount claimed in its return on November 3, 1922, whereas the amount finally determined in 1923 was $25,228.35. While the amount claimed of $45,090.57 was reasonably close to the amount of $42,594.76 found by the Commission to be due before making the all-important adjustments of maintenance charges, etc. under paragraph (f) of Section 209, the amount claimed exceeded the amount finally allowed by more than 75 per cent. This is not the reasonably close estimate which the Court of Claims assumed the carrier to be able to make for the purpose of accrual in 1920. The very findings of the Court

of Claims (Finding 4) disclose its error in stating that "There appears to have been no substantial dispute between the plaintiff and the Interstate Commerce Commission as to its claim." Nor is it correct to say that the delay in the payment of the plaintiff's claim was due to the failure of the plaintiff to report the facts to the Commission, for, as is shown above, the Commission itself had not determined the basis of computation of the amount due until a later year.

In view of the controversy between the Commission and the carriers with regard to the adjustments of maintenance and other expenses required by Section 209 and the inability of carriers to obtain any amount in final settlement except upon agreement with the Commission, the situation is like that involved in *Lucas* v. *American Code Company, Inc.*, 280 U. S. 445. That case is distinguished by the Court of Claims on the ground that the plaintiff in that case was not a common carrier subject to interstate commerce regulations which prescribed its method of accounting. It has already been pointed out that in its determination of railway operating income the Commission departed from the regular accounting methods prescribed by it. The classifications of accounts of the Commission require the adjustment in later years of entries made in the particular year so as to reflect the actual outcome of transactions as to which there could be nothing but estimates on the books in the earlier year. Such a method of bookkeeping, while approaching an ideal of exactness, is entirely impracticable in the administration of the Revenue Acts. These require the determination of income by taxpayers annually, on the basis of data available to them. The crucial point which the Court of Claims thus failed to regard is the practical one stated at this term by Mr. Justice Butler in *United States Cartridge Co.* v. *United States*, 52 S. Ct. 243, 246-247:

> "The tax laws are calculated to produce revenue ascertainable and payable at regular intervals. Otherwise it would not be practicable to devise methods of accounting, assessment or collection capable of operation. Burnet *v.* Sanford & Brooks Co., 282 U. S. 359, 365."

To require the returns to be adjusted on the basis of information which in the nature of things can not be obtained until a much later date (when statutes of limitations may have run) is not only impracticable but, we submit, contrary to the plain intent of Congress. We believe that it was for this reason that this Court said at this term in *Old Colony R. R. Co.* v. *Commissioner*, 52 S. Ct. 211, by Mr. Justice Roberts (p. 214):

> "Moreover, the rules of accounting enforced upon a carrier by the Interstate Commerce Commission are not binding upon the Commissioner; nor may he resort to the rules of that body, made for other purposes, for the determination of tax liability under the revenue acts."

The case of *Burnet* v. *Sanford & Brooks Company*, 282 U. S. 359, affords a close parallel to the case at bar. In that case the taxpayer had received in 1920, pursuant to judgment against the United States, an amount compensatory of the cost of work done by the taxpayer in the years 1913 to 1916, the expenses of which had been deducted in the returns for those years. The Circuit Court of Appeals held, reversing an order of the Board of Tax Appeals, that the amount received in 1920 was not income, but it conditioned the reversal upon the filing by the taxpayer of amended returns for the years 1913 to 1916, from which were to be omitted the deductions of the related items of expenses paid in those years. This Court reversed the judgment. The decision clearly shows that the accrual basis of making income tax returns does not require that all items of income be reported in the return for the year to which they relate, but that there was a "practical necessity of computing the tax on the basis of annual or other fixed taxable periods, which might result in the taxpayer being required to pay a tax on income in one period exceeded by net losses in another." The petitioner's return for 1920 was therefore in accordance with law, although it did not report the amount paid by the United States in 1923, pursuant to a quasi-judicial finding by the Interstate Commerce Commission under a statute enacted in 1920. The test is not to what year the item relates, but in what year the events occur which enable its amount to be fixed.

It is submitted, on the grounds heretofore stated, that in the case at bar the events which enabled the amount of the payment to be fixed had not occurred in 1920, and the amount could therefore not be accrued. *Cf. United States* v. *Anderson*, 269 U. S. 422, 441. In that case all the events had occurred, at the close of the taxable year from which the munitions tax could be precisely determined, under a formula involving no adjustment in later years of entries, recording the events of the taxable year, made in accordance with the regular accrual method of bookkeeping practiced by the taxpayer. In the case at bar the formula for determining the payment to be made under Section 204 involved the exercise of discretion, as to facts to be considered and adjustments of prices and expenses to be made, by an independent body whose judgment was apparently uncontrolled by the judiciary. The calculation of the munitions tax for the year 1916 involved in the *Anderson* case could be made by the taxpayer itself at the end of that year on the basis of facts established during the year. The calculation of payments under Section 204 or Section 209 of the Transportation Act could not be made by the carrier at the end of the year 1920 on the basis of facts established during that year. Nothing that happened after the end of the year 1916 could affect the liability for munitions tax for that year. On the other hand, payments under Section 204 or Section 209 of the Transportation Act were conditioned on events that did not happen in 1920 and, in view of the complexity of the questions to be decided before the necessary discretion by the Interstate Commerce Commission could be exercised, could not have happened in 1920.

It is submitted, therefore, that the apparently unenforceable obligation of the United States to pay an amount to be determined by the Interstate Commerce Commission in accordance with discretionary principles not announced by it during 1920, payment of which was obtainable only upon action by the Commission apparently uncontrolled by the courts and only upon agreement by the carrier not to claim more, could not be accrued for income tax purposes in the year 1920. To do so would be to postpone the assessment of the tax for 1920 for an indefinite period, in order to ascertain more precisely

the final outcome of the period, and to depart from the annual basis of income taxation which all the revenue acts have adopted. *Burnet* v. *Sanford & Brooks Co.*, 282 U. S. 359, 365.

VII. CONCLUSION.

In view of the foregoing it is respectfully submitted that this Honorable Court should reverse and set aside the decision and judgment of the Court of Claims so far as it pertains to the item of $25,228.35 which was paid to the Cimarron and Northwestern Railway Company in 1923 under the provisions of Section 204 of the Transportation Act of 1920, and hold that such payment did not constitute taxable income to the recipient or, if it was taxable income, that it was returnable in the year 1923 when the amount was determined and paid.

Respectfully submitted,

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APPENDIX.

Excerpts from the Revenue Act of 1918:

"SEC. 213. That for the purposes of this title * * * the term 'gross income'—

"(a) Includes gains, profits, and income derived from salaries, wages, or compensation for personal service (including in the case of the President of the United States, the judges of the Supreme and inferior courts of the United States, and all other officers and employees, whether elected or appointed, of the United States, Alaska, Hawaii, or any political subdivision thereof, or the District of Columbia, the compensation received as such), of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. The amount of all such items shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under subdivision (b) of Section 212, any such amounts are to be properly accounted for as of a different period; but

"(b) Does not include the following items, which shall be exempt from taxation under this title:

* * * * * * * * *

"(3) The value of property acquired by gift, bequest, devise or descent (but the income from such property shall be included in gross income); * * *."

Excerpts from the Transportation Act of 1920:

"SEC. 204. (a) When used in this section—

"The term 'carrier' means a carrier by railroad which, during any part of the period of Federal control, engaged as a common carrier in general transportation, and competed for traffic, or connected, with a railroad under Federal control, and which sustained a deficit in its railway operating income for that portion (as a whole) of the period of Federal control during which it operated its own railroad or system of transportation; but does not include any street or interurban electric railway which has as its principal source of operating revenue urban, suburban, or interurban passenger traffic or sale of power, heat, and light, or both; and

"The term 'test period' means the three years ending June 30, 1917.

"(b) For the purposes of this section—

"Railway operating income or any deficit therein for the period of Federal control shall be computed in a manner similar to that provided in section 209 with respect to such income or deficit for the guaranty period; and

"Railway operating income or any deficit therein for the test period shall be computed in the manner provided in section 1 of the Federal Control Act.

"(c) As soon as practicable after March 1, 1920, the Commission shall ascertain for every carrier, for every month of the period of Federal control during which its railroad or system of transportation was not under Federal operation, its deficit in railway operating income, if any, and its railway operating income, if any (hereinafter called 'Federal control return'), and the average of its deficit in railway operating income, if any, and of its railway operating income, if any, for the three corresponding months of the test period taken together (hereinafter called 'test period return'): *Provided*, That 'test period return' in the case of a carrier which operated its railroad or system of transportation for at least one year during, but not for the whole of, the test period, means its railway operating income, or the deficit therein, for the corresponding month during the test period, or the average thereof for the corresponding months during the test period taken together, during which the carrier operated its railroad or system of transportation.

"(d) For every month of the period of Federal control during which the railroad or system of transportation of the carrier was not under Federal operation, the Commission shall then ascertain (1) the difference between its Federal control return, if a deficit, and its test period return, if a smaller deficit, or (2) the difference between its test period return, if an income, and its Federal control return, if a smaller income, or (3) the sum of its Federal control return, if a deficit, plus its test period return, if an income. The sum of such amounts shall be credited to the carrier.

"(e) For every such month the Commission shall then ascertain (1) the difference between the carrier's Federal control return, if an income and its test period return, if a smaller income, or (2) the difference between its test period return, if a deficit, and its Federal control return, if a smaller deficit, or (3) the sum of its Federal control return, if an income, plus its test period return, if a deficit. The sum of such amounts shall be credited to the United States.

"(f) If the sum of the amounts so credited to the carrier under subdivision (d) exceeds the sum of the amounts so credited to the United States under subdivision (e), the difference shall be payable to the carrier. In the case of a carrier which operated its railroad or system of transportation for less than a year during, or for none of, the test period, the foregoing computations shall not be used, but there shall be payable to such carrier its deficit in railway operating income for that portion (as a whole) of the period of Federal control during which it operated its own railroad or system of transportation.

"(g) The Commission shall promptly certify to the Secretary of the Treasury the several amounts payable to carriers under paragraph (f). The Secretary of the Treasury is hereby authorized and directed thereupon to draw warrants in favor of each such carrier upon the Treasury of the United States for the amount shown in such certificate as payable thereto. An amount sufficient to pay such warrants is hereby appropriated out of any money in the Treasury not otherwise appropriated."

SEC. 209. (a) When used in this section—

The term "carrier" means (1) a carrier by railroad or partly by railroad and partly by water, whose railroad or system of transportation is under Federal control at the time Federal control terminates, or which has heretofore engaged as a common carrier in general transportation and competed for traffic, or connected, with a railroad at any time under Federal control; and (2) a sleeping car company whose system of transportation is under Federal control at the time Federal control terminates; but does not include a street or interurban electric railway not under Federal control at the time Federal control terminates, which has as its principal source of operating revenue urban, suburban, or interurban passenger traffic or sale of power, heat, and light, or both;

The term "guaranty period" means the six months beginning March 1, 1920.

The term "test period" means the three years ending June 30, 1917; and

The term "railway operating income" and other references to accounts of carriers by railroad shall, in the case of a sleeping car company, be construed as indicating the appropriate corresponding accounts in the accounting system prescribed by the Commission.

(b) This section shall not be applicable to any carrier which

does not on or before March 15, 1920, file with the Commission a written statement that it accepts all the provisions of this section.

(c) The United States hereby guarantees—

(1) With respect to any carrier with which a contract (exclusive of so-called cooperative contracts or waivers) has been made fixing the amount of just compensation under the Federal Control Act, that the railway operating income of such carrier for the guaranty period as a whole shall not be less than one-half the amount named in such contract as annual compensation or, where the contract fixed a lump sum as compensation for the whole period of Federal operation, that the railway operating income of such carrier for the guaranty period as a whole shall not be less than an amount which shall bear the same proportion to the lump sum so fixed as six months bears to the number of months during which such carrier was under Federal operation, including in both cases the increases in such compensation provided for in section 4 of the Federal Control Act;

(2) With respect to any carrier entitled to just compensation under the Federal Control Act, with which such a contract has not been made, that the railway operating income of such carrier for the guaranty period as a whole shall not be less than one-half of the annual amount estimated by the President as just compensation for such carrier under the Federal Control Act, including the increases in such compensation provided for in section 4 of the Federal Control Act. If any such carrier does not accept the President's estimate respecting its just compensation, and if, in proceedings under section 3 of the Federal Control Act it is determined that a larger or smaller annual amount is due as just compensation, the guaranty under this paragraph shall be increased or decreased accordingly;

(3) With respect to any carrier, whether or not entitled to just compensation under the Federal Control Act, with which such a contract has not been made, and for which no estimate of just compensation is made by the President, and which for the test period as a whole sustained a deficit in railway operating income, the guaranty shall be a sum equal to (a) the amount by which any deficit in its railway operating income for the guaranty period as a whole exceeds one-half of its average annual deficit in railway operating income for the test period, plus (b) an amount equal to one-half the annual sum fixed by the President under section 4 of the Federal Control Act;

(4) With respect to any carrier not entitled to just com-

pensation under the Federal Control Act, which for the test period as a whole had an average annual railway operating income, that the railway operating income of such carrier for the guaranty period as a whole shall not be less than one-half the average annual railway operating income of such carrier during the test period.

(d) If for the guaranty period as a whole the railway operating income of any carrier entitled to a guaranty under paragraph (1), (2), or (4) of subdivision (c) is in excess of the minimum railway operating income guaranteed in such paragraph, such carrier shall forthwith pay the amount of such excess into the Treasury of the United States. If for the guaranty period as a whole the railway operating income of any carrier entitled to a guaranty under paragraph (3) of subdivision (c) is in excess of one-half of the annual sum fixed by the President with respect to such carrier under section 4 of the Federal Control Act, such carrier shall forthwith pay the amount of such excess into the Treasury of the United States. The amounts so paid into the Treasury of the United States shall be added to the funds made available under section 202 for the purposes indicated in such section. Nothwithstanding the provisions of this subdivision, any carrier may retain out of any such excess any amount necessary to enable it to pay its fixed charges accruing during the guaranty period.

(e) For the purposes of this section railway operating income, or any deficit therein, for the test period shall be computed in the manner provided for in section 1 of the Federal Control Act.

(f) In computing railway operating income, or any deficit therein, for the guaranty period for the purposes of this section—

(1) Debits and credits arising from the accounts, called in the monthly reports to the Commission equipment rents and joint facility rents, shall be included, but debits and credits arising from the operation of such street electric passenger railways, including railways commonly called interurbans, as are not under Federal control at the time of termination thereof, shall be excluded;

(2) Proper adjustments shall be made (a) in case any lines which were, during any portion of the period of Federal control, a part of the railroad or system of transportation of the carrier, and whose railway operating income was included in such income of the carrier for the test period, do not continue to be a part of such railroad or system of transportation during the entire guaranty period, and (b) in case of any lines acquired by, leased to, or consolidated with, the railroad or system of

transportation of the carrier at any time since the end of the test period and prior to the expiration of the guaranty period, for which separate operating returns to the Commission are not made in respect to the entire portion of the guaranty period;

(3) There shall not be included in operating expenses, for maintenance of way and structures, or for maintenance of equipment, more than an amount fixed by the Commission. In fixing such amount the Commission shall so far as practicable apply the rule set forth in the proviso in paragraph (a) of section 5 of the "standard contract" between the United States and the carriers (whether or not such contract has been entered into with the carrier whose railway operating income is being computed);

(4) There shall not be included any taxes paid under Title I or II of the Revenue Act of 1917, or such portion of the taxes paid under Title II or III of the Revenue Act of 1918 as by the terms of such Act are to be treated as levied by an Act in amendment of Title I or II of the Revenue Act of 1917; and

(5) The Commission shall require the elimination and restatement of the operating expenses and revenues (other than for maintenance of way and structures, or maintenance of equipment) for the guaranty period, to the extent necessary to correct and exclude any disproportionate or unreasonable charge to such expenses or revenues for such period, or any charge to such expenses or revenues for such period which under a proper system of accounting is attributable to another period.

(g) The Commission shall, as soon as practicable after the expiration of the guaranty period, ascertain and certify to the Secretary of the Treasury the several amounts necessary to make good the foregoing guaranty to each carrier. The Secretary of the Treasury is hereby authorized and directed thereupon to draw warrants in favor of each such carrier upon the Treasury of the United States, for the amount shown in such certificate as necessary to make good such guaranty. An amount sufficient to pay such warrants is hereby appropriated out of any money in the Treasury not otherwise appropriated.

(h) Upon application of any carrier to the Commission, asking that during the guaranty period there may be advanced to it from time to time such sums, not in excess of the estimated amount necessary to make good the guaranty, as are necessary to enable it to meet its fixed charges and operating expenses, the Commission may certify to the Secretary of the Treasury the amount of, and times at which, such advances, if any, shall be made. The Secretary of the Treasury, on receipt of

such certificate, is authorized and directed to make the advances in the amounts and at the times specified in the certificate, upon the execution by the carrier of a contract, secured in such manner as the Secretary may determine, that upon final determination of the amount of the guaranty provided for by this section such carrier will repay to the United States any amounts which it has received from such advances in excess of the guaranty, with interest at the rate of 6 per centum per annum from the time such excess was paid. There is hereby appropriated, out of any money in the Treasury not otherwise appropriated, a sum sufficient to enable the Secretary of the Treasury to make the advances referred to in this subdivision.

Amendment to the Transportation Act of 1920 (enacted February 26, 1921).

"SEC. 212. (a) In making certifications under section 204 or section 209, the Commission, if not at the time able finally to determine the whole amount due under such section to a carrier or the American Railway Express Company, may make its certificate for any amount definitely ascertained by it to be due, and may thereafter in the same manner make further certificates, until the whole amount due has been certified. The authority of and direction to the Secretary of the Treasury under such sections to draw warrants is hereby made applicable to each such certificate. Warrants drawn pursuant to this section, whether in partial payment or in final payment, shall be paid: (1) If for a payment in respect to reimbursement of a carrier for a deficit during the period of Federal control, out of the appropriation made by section 204; (2) If for a payment in respect to the guaranty to a carrier other than the American Railway Express Company, out of the appropriation made by subdivision (g) of section 209; and (3) if for a payment in respect to the guaranty to the American Railway Express Company, out of the appropriation made by the fifth paragraph of subdivision (i) of section 209.

"(b) In ascertaining the several amounts payable under either of such sections, the Commission is authorized, in the case of deferred debits and credits which can not at the time be definitely determined, to make, whenever in its judgment practicable, a reasonable estimate of the net effect of any such items, and, when agreed to by the carrier or express company, to use such estimate as a definitely ascertained amount in certifying amounts payable under either of such sections, and such estimates so agreed to shall be prima facie but not conclusive evidence of their correctness in amount in final settlement."